NCUA News
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National Credit Union Administration

Credit unions continue strong performance as members benefit

Net worth remains high

The nation's federally insured credit unions are well capitalized, with net worth near a 5-year high at 10.93 percent, according to first-quarter 2005 Call Report data submitted by the nation's 8,945 federally insured credit unions.

Earnings remain strong. Credit unions reported a 0.92 percent return on average assets, and as loans grew at a 4.57 percent annualized rate, loan delinquencies continued to decline.

"Loan delinquency is near a 3-year low at 0.64 percent, and net charge-offs also declined in the first quarter of 2005," Chairman JoAnn Johnson said. "In fact, total loan delinquencies declined 9.4 percent in the first three months of 2005 while recoveries grew an annualized 18.8 percent. Credit unions consistently exhibit strong performance as they help members benefit from the healthy economic climate, and NCUA is doing its part by acting to reduce regulatory burden and encourage legislation to enhance and maintain a safe, sound credit union system."

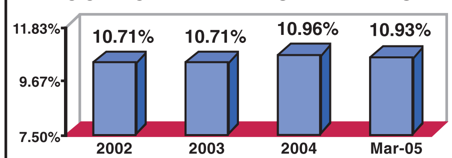
The major balance sheet categories and membership growth at federally insured credit unions between year-end 2004 and March 31, 2005, follows:

- Assets increased 2.38 percent, to $662.4 billion from $647.0 billion;
- Loans increased 1.14 percent, to $418.9 billion from $414.3 billion;
- Shares increased 2.54 percent, to $570.2 billion from $556.1 billion;
- Investments increased 2.52 percent, to $163.7 billion from $159.7 billion;
- Net worth increased 2.11 percent, to $72.4 billion from $70.9 billion; and
- Membership grew 0.57 percent, to 84.0 million members.

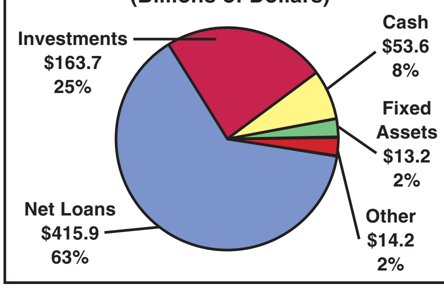
In the past 12 months, federally insured credit union membership grew by 1.2 million people while assets grew by $34.7 billion. Net long-term assets remain near all-time highs at 25.18 percent. Credit unions should have adequate interest rate risk measurement processes in place as well as asset/liability management policies and procedures sufficient for their level of risk.

A consolidated balance sheet, with first quarter data, is available on the NCUA website at http://www.ncua.gov/data/FOIA/foia.html.

AGGREGATE NET WORTH RATIO



ASSET DISTRIBUTION
(Billions of Dollars)



HIGHLIGHTS

Washington, D.C., June 16, 2005 *– President George W. Bush with Chairman JoAnn Johnson at the kick-off of the President's national outreach effort to bring together medical, community, and local partners with the Federal government to educate seniors and Americans with disabilities about the new Medicare prescription drug benefit.*

See story on page 6.

Help protect member's identity

Recent media attention about attempts to steal personal financial information through a process known as "phishing" points out the increased sophistication of Internet criminals and the targeting of smaller financial institutions. As more credit unions offer members access to transactional internet sites, the potential for members to fall prey to criminal activity grows.

"This continues to be a significant problem facing all consumers," said Chairman Johnson. "I encourage all credit unions, which provide convenient transactional web sites to members, to take the necessary action to assist your members in protecting their identity."

NCUA has issued several Letters to Credit Unions that provide guidance, as well as pamphlets for members that explain "phishing" and the steps members can take to protect themselves, such as never providing financial information in response to unsolicited e-mail messages.

The agency encourages credit unions to utilize and share with members, as applicable, the educational tools provided in the following Letters to Credit Unions:

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NCUA News

National Credit Union Administration

NCUA News is published by the National Credit Union Administration, the federal agency which supervises and insures credit unions.

JoAnn Johnson, *Chairman*
Deborah Matz, *Board Member*

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Matz shares lessons learned from CDCUs

San Francisco, June 9, 2005 *– Board Member Matz receives a plaque of appreciation recognizing her efforts over the past three years from leaders of the National Federation of Community Development Credit Unions. Presenting the award are Federation Chairwoman Rita Haynes (center), CEO of Faith Community United Credit Union, Cleveland, Ohio; and Federation Board Member Eunice Rogers, CEO of NRS Community Development Federal Credit Union, Birmingham, Alabama.*

NCUA Board Member Debbie Matz shared some of the valuable lessons she learned from Community Development Credit Unions (CDCUs) and her resulting initiatives to help small credit unions thrive in her keynote address to the National Federation of Community Development Credit Unions' 31st Annual Meeting June 9, 2005, in San Francisco.

"When I came to NCUA, I decided to get out of the office, travel the country and see first-hand what credit unions are really all about," Matz began. "The more I met with leaders of community development credit unions, the more valuable lessons I learned:"

- "I learned the true meaning of 'People Helping People.' It means treating each member, regardless of their income or their credit history, with respect and compassion. It means listening to each member's hopes and aspirations, and doing everything in your power to help them achieve their dreams. It means turning 'Heck no, not with your credit history,' into 'Yes, let's work together and make it happen."
- "I learned that 'low income' does not automatically mean 'high credit risk.' People with low incomes can actually be better credit risks than people with high incomes – because they will do everything they can to pay off their loans and build good credit."
- "I learned that community development credit unions are shining examples of how all credit unions can and should be serving people of modest means. And I concluded that all credit unions owe CDCUs a debt of gratitude – because by fulfilling credit unions' statutory mission, CDCUs help to preserve all credit unions' tax exemption."

"I feel confident that CDCUs represent not only the past, but the future of credit unions," Matz concluded. "You make a lasting difference in the lives of your members, their children and future generations to come. You are living proof that credit unions continue to fulfill their statutory mission to serve people of modest means. If all credit unions stay true to the mission that you live by each and every day, the future of credit unions will be as robust and rewarding as your past."

The full text of Board Member Matz's speech is online at http://www.ncua.gov/news/speeches/speeches_matz.html

Johnson urges CUs to manage risk in a growing economy

As the nation's economy charts a robust course, creating more jobs and increasing productivity, Chairman JoAnn Johnson told credit union executives they must be prepared to closely manage risk as it relates to the rise in interest rates, among others indicators.

Chairman Johnson said that credit unions are positioned for sustained safety and soundness; however, challenges will require credit unions to monitor risks in consideration of the country's economic condition.

"With nearly 3.5 million jobs created since May 2003, home sales climbing to an all time high, productivity at a 9-month high and manufacturing on the rise, credit unions play a vital role in ensuring continued growth, while also balancing the risks associated with each institution's diverse portfolios," Chairman Johnson said.

Economic conditions are an integral part in determining the environment in which credit unions operate. It is especially important currently, when the direction of the economy is still growing. Chairman Johnson said the agency's capital markets and examination and insurance teams continuously watch and analyze economic developments to ensure the agency is enabling credit unions to take advantage of presented opportunities, yet do so in a safe and effective manner.

NCUA has identified economic fundamentals which are of utmost importance to credit unions at this point in time – interest rates, consumer spending and employment. Among them, interest rates are of special concern to credit unions, as well as to the overall economy.

- **Increasing interest rates** can negatively impact credit unions' interest margins, liquidity, and credit quality of their members, potentially creating an earnings squeeze. They could also negatively impact mortgage demand, changing the composition of credit unions' loan portfolios. With both short- and long-term interest rates expected to increase this year, NCUA examiners are paying special attention to the position of credit union balance sheets;
- **Consumer spending** represents 70 percent of economic activity and is very important; and
- **Employment growth** has been improving and will be vitally important going forward as the economy will need jobs and income growth to support consumer spending. It also has a major impact on confidence and households' ability to borrow and service debt.

Because economic conditions differ between states and regions, NCUA not only analyzes overall macroeconomic conditions, but also analyzes regional and state economic development to gain a better understanding of localized credit union performance.

"We provide our examiners with knowledge on current regional economic conditions to enable them to make informed decisions and discuss changing conditions with credit union managers," said Chairman Johnson. "We constantly analyze the implications of economic, as well as other developments, to determine potential impact on credit unions' operations, loan and membership growth, and decision making ability. Our role as a regulator is to help ensure a safe and sound operating environment exists for credit unions to compete and prosper."

Home equity lending guidance issued

NCUA and fellow financial regulators issued guidance in May to promote sound risk management practices for home equity lines of credit and loans. In some cases, credit risk management practices for home equity lending have not kept pace with the product's rapid growth and eased underwriting standards.

Along with vulnerability to interest rate increases, some of the risk factors causing concern are:

- Interest-only features that require no amortization of principal for a protracted period;
- Limited or no documentation of a borrower's assets, employment and income;
- Higher loan-to-value (LTV) and debt-to-income ratios;
- Lower credit risk scores for underwriting home equity loans;
- Greater use of automated valuation models and other collateral evaluation tools for the development of appraisals and evaluations; and
- An increased number of transactions generated through a loan broker or other third party.

The guidance is available on the NCUA website at http://www.ncua.gov/letters/2005/CU/05-CU-07-encl.pdf.

Protect member's identity

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- *Phishing Guidance for Credit Union Members, No. 04-CU-12,* issued September 2004; online at http://www.ncua.gov/letters/2004/04-CU-12.pdf, and the attached "FFIEC Phishing Brochure," online at http://www.ncua.gov/Publications/brochures/IdentityTheft/PhishBrochure-Web.pdf.
- *E-Mail and Internet Related Fraudulent Schemes Guidance, No. 04-CU-06,* issued April 2004; online at http://www.ncua.gov/letters/2004/04-CU-06.pdf.
- *Fraudulent E-Mail Schemes No. 04-CU-05,* issued April 2004; online at http://www.ncua.gov/letters/2004/04-CU-05.pdf.

Who and What: Chairman JoAnn Johnson will address the National Association of Federal Credit Unions' 38th Annual Conference & Exhibition.
When: Thursday, July 14, 2005
Where: Mandalay Bay Resort, Las Vegas, Nev.
Why: To provide an update on current issues affecting federal credit unions.
Contact: Linda Queen at 703-518-6309 or lqueen@ncua.gov

Who and What: Board Member Debbie Matz will address the National Association of Federal Credit Unions' 38th Annual Conference & Exhibition.
When: Friday, July 15, 2005
Where: Mandalay Bay Resort, Las Vegas, Nev.
Why: To address the general session on the future of the federal credit union system; and participate in a special session to help credit unions provide affordable mortgages in new markets.
Contact: Patty Jenkins at 703-518-6318 or pjenkins@ncua.gov

Who and What: Chairman JoAnn Johnson will address the American Association of Credit Union Leagues Summer Meeting.
When: Friday, July 15, 2005
Where: New York, N.Y.
Why: To provide an overview of NCUA regulatory issues affecting the credit union system.
Contact: Linda Queen at 703-518-6309 or lqueen@ncua.gov

Who and What: Chairman JoAnn Johnson will address the Regulators' Round Table 2005 World Credit Union Conference.
When: Sunday, July 24, 2005
Where: Rome, Italy
Why: To provide an update on the risk based examination process and risk based capital proposal.
Contact: Linda Queen at 703-518-6309 or lqueen@ncua.gov

Chairman JoAnn Johnson testifies on regulatory relief

Johnson emphasizes CURIA provisions and addresses conversion procedure questions

Chairman JoAnn Johnson presented the agency's views on regulatory efficiency and reform initiatives for credit unions June 9, 2005, before the House Financial Institutions and Consumer Credit Subcommittee.

"It is certainly in the interest of the regulator for credit unions to have burdensome regulations eliminated," said Chairman Johnson. "The health of the industry going forward is dependent on credit unions being able to be competitive in a changing financial marketplace. The regulatory improvements and relief sought is consistent in ensuring safety and soundness for the nation's credit unions.

"NCUA appreciates Chairman Bachus for his leadership in calling this hearing and values the opportunity to present NCUA views regarding needed regulatory relief and improvements to the Federal Credit Union Act. Additionally, NCUA supports credit union provisions in the recently introduced Credit Union Regulatory Improvements Act (CURIA) of 2005," Chairman Johnson said. "It addresses some of the most compelling statutory and regulatory reform issues being discussed within the credit union industry today."

Also, in response to questions regarding NCUA's disclosure process for credit unions desiring to convert to a mutual savings bank Chairman Johnson stated, "As member-owned financial cooperatives, credit union members have the right to choose the charter they deem most appropriate for their membership. Likewise, as member-owned institutions, it is incumbent upon the leadership of these credit unions to provide full disclosure to their members and comply with the required disclosure requirements. With potential consequences such as losing equity and ownership in the institution, clarity must remain a vital part of the disclosure process. It is important for credit union members to be fully informed so they may cast an educated and meaningful vote."

Johnson urges Congress to adopt vital CURIA relief

Chairman Johnson recommended a statutory change authorizing NCUA to implement a risk-based prompt corrective action (PCA) system for federally insured credit unions.

"Reforming capital standards is vital for credit unions as other federal financial regulators explore implementation of capital reforms," Chairman Johnson said. "While maintaining a leverage ratio, NCUA's PCA reform proposal incorporates a risk-based approach to credit union capital standards."

The NCUA's proposed reform takes into account the low-risk nature of credit unions. For the leverage requirement, NCUA supports a reduction in the standard net worth (i.e., leverage) ratio requirement for credit unions to a level comparable to FDIC requirements. The current minimum leverage ratio for well-capitalized credit unions is set by statute at 7 percent, compared to 5 percent for FDIC-insured institutions.

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Interim final rules issued on medical information

NCUA and fellow financial regulators issued interim final rules, under the Fair Credit Reporting Act (FCRA), to create exceptions to the statutory prohibition on creditors obtaining or using medical information in connection with determining credit eligibility. The interim rules also address sharing medically related information among affiliates.

The effective date is nine months after the early June 2005 publication in the Federal Register.

The Fair and Accurate Credit Transactions Act of 2003 (FACT Act) amended FCRA so a creditor may not obtain or use medical information in connection with determining a consumer's eligibility, or continued eligibility, for credit, except as permitted by regulations. The FACT Act required agencies to draft regulations permitting creditors to obtain and use medical information for eligibility purposes when necessary and appropriate to protect legitimate operational, transactional, risk, consumer and other needs. A proposed rule was published for comment April 28, 2004.

The interim final rules create exceptions to the general statutory prohibition on obtaining and using medical information. The provisions are similar to those contained in the proposed rule and include exceptions for financial information, the financing of medical procedures, requests for medical accommodations, and forbearance, among others. The agencies have expanded the scope of the rules so the exceptions will apply to all creditors, not just to creditors ordinarily regulated by one of the agencies. In addition to each of the financial agencies rules, a substantively identical sixth rule was added that covers creditors not subject to the five agency rules.

The FACT Act also amended FCRA to limit the ability of creditors and others to share medically related information among affiliates, except as permitted by the statute, regulation or order. The interim final rules specify the circumstances in which creditors may share such information among affiliates without becoming consumer reporting agencies.

Issued by the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, and Office of Thrift Supervision, the rules of each agency are substantively identical.

Comments on the interim final rules are requested within 30 days after publication in the Federal Register, which was on or about June 7th. The interim final rule is available on the NCUA website at *http://www.ncua.gov/RegulationsOpinionsLaws/rules_and_regs/rules_and_regs.html.*

Vital CURIA relief

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"This places credit unions at a competitive disadvantage when not warranted to protect the insurance fund," Chairman Johnson said.

Additional relief measures sought

Additional regulatory relief provisions Chairman Johnson requested for federal credit unions (FCUs) include the following:

- Enable "retained earnings" of merging institutions to classify as net worth following a merger;
- Authorize FCUs to offer check cashing and money transfer services for potential members, particularly those left behind to predatory and high-cost financial companies;
- Eliminate12-year maturity loan limits;
- Increase investment limits in CUSOs to 3 percent, or give NCUA the ability to set the limit;
- Expand investment options;
- Eliminate spin-off considerations when FCUs voluntary merge; and
- Provide parity relief for SEC registration requirements.

Lending Alert:

Outsourced, indirect, subprime lending due diligence is vital

Since September 2004, there has been a sharp increase in the number of credit unions engaged in outsourced, indirect, subprime automobile lending and participation activity in such loans. NCUA is concerned that credit unions engaged in this type of lending may not have effective controls and monitoring systems in place. In response, on June 13, 2005, NCUA issued *Risk Alert 05-Risk-01, Specialized Lending Activities—Third-Party Subprime Indirect Lending and Participations* to all federally insured credit unions.

The Risk Alert expands on the controls discussed in the September 2004 *Letter to Credit Unions 04-CU-13, Specialized Lending Activities*, and specifies minimum due diligence sound business practices related to indirect, subprime lending involving third-party vendors. It is NCUA's position that sound business practices for subprime lending require, at a minimum, credit unions to:

- Regularly analyze the program's impact on the credit union's net worth;
- Properly evaluate and oversee third-party vendor's subprime underwriting criteria;
- Limit third-party vendor's authority to alter loan terms;
- Test the accuracy of third-party vendor's reports, and, if appropriate;
- Include an exit clause in third-party vendor's servicing agreement.

Examiners have begun contacting credit unions to discuss controls and practices. Failure to implement effective controls and monitoring systems will result in frequent supervision contacts and appropriate administrative action.

Credit unions vital to Medicare benefits awareness

America's credit unions are positioned to be a catalyst in a nationwide outreach initiative to reach millions of seniors and disabled Americans who are eligible for enhanced Medicare benefits, says NCUA Chairman JoAnn Johnson.

"The federal government will work hard to ensure that Medicare beneficiaries understand their options," said President Bush. "I've asked every agency that touches the lives of seniors or disabled Americans to devote resources to explaining the prescription drug benefit. And we need the help of the private sector, as well. The only way to reach everyone on Medicare is to mobilize compassionate citizens in communities all over the country."

President Bush expressed his appreciation to Chairman Johnson for the work of the nation's credit unions involved in economic empowerment.

"With over 83 million members, credit unions have a great opportunity to be part of this nationwide initiative and assist in this awareness campaign for Medicare beneficiaries," said Chairman JoAnn Johnson. "Everyday, credit unions fulfill the 'people helping people' philosophy, and the awareness of the new enrollment process will be vital for ensuring their members receive these new and enhanced benefits. We call on credit unions to join in this awareness campaign."

The Medicare Modernization Act created a prescription drug benefit. Effective January 1, 2006, the new coverage will help all Medicare beneficiaries pay for prescription drugs, offer better choices of plans and drug benefits, and provide extra help to beneficiaries with limited income and resources. The enhanced Medicare benefits will pay nearly all low-income beneficiaries' drug costs and about one-third of seniors will be eligible for a Medicare drug benefit without premiums, deductibles, or gaps in coverage. Co-payments will amount to no more than $5 for most people, and more than 95 percent of their drug bills will be covered.

"Credit unions are answering the call of service by providing health savings accounts, and informing their senior and disabled members about this opportunity will be an added value to their credit union family," said Chairman Johnson. "Whether it's a statement stuffer, poster in a branch, newsletter or other means to enhance awareness, it makes a tremendous difference."

Timeline for the Awareness Campaign

- June-September, 2005: Awareness + limited income enrollment
- October, 2005: Support for prescription drug plan enrollment
- November 15, 2005: Open enrollment period begins
- January 1, 2006: Prescription drug coverage starts
- May 15, 2006: Open enrollment period ends

"It is important that beneficiaries are informed as soon as possible, because like any other insurance, they will pay more if they don't enroll during the open enrollment period," Johnson said.

All beneficiaries will receive a new handbook, "Medicare and You," in October, containing specific information about the new prescription drug plans available. For beneficiary questions, call 1-800-MEDICARE or visit www.medicare.gov for answers.

Organizations interested in MedicareRx outreach information and materials can visit: http://www.cms.hhs.gov/partnerships/

Visit NCUA's website
www.ncua.gov

Credit unions can sign up for Express E-Subscription Service. Others can get the latest information by "RSS Feed" at

http://www.ncua.gov/RSS/NCUAChanges.xml.

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